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C O N F I D E N T I A L SECTION 01 OF 03 BRASILIA 001973

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TAGS: [PGOV](#) [PREL](#) [BR](#)

SUBJECT: BRAZIL SCANDAL: THE "OFFICIAL STORY" CRUMBLES AS INVESTIGATIONS INTENSIFY

REF: A. BRASILIA 1494

[B](#). BRASILIA 1544

[C](#). BRASILIA 1622

[D](#). BRASILIA 1631

[E](#). BRASILIA 1819

[F](#). BRASILIA 1867

[G](#). BRASILIA 1849

Classified By: Political Counselor Dennis Hearne. Reasons 1.4
(b)(d)

[1](#)1. (C) Summary: The scandals (reftels) affecting the government of President Lula da Silva and his PT party reached a serious new level in recent days. Former PT officers implicated in the alleged financial improprieties have now attempted to present suspect financial transfers managed by a private sector facilitator on the PT's behalf as being used solely for off-the-books contributions to cover PT campaign debts, and not as illegal payoffs to mercenary politicians to secure votes. As such, the transfers would be confessed violations of electoral regulations, but not criminal offenses. In a TV interview on 17 July President Lula da Silva essentially blessed this version of events. But congressional investigating committees (CPIs), judicial and media inquiries are uncovering information daily that give the lie to that "official story," and point to the probable existence of schemes whereby huge quantities of public moneys were diverted by PT officials and their private sector moneymen into potentially criminal transactions, including bribes to secure votes. As bank records are unsealed by investigators, revealing the breadth of the schemes, the immense amount of money involved, and names of prominent politicians from various parties, questions are intensifying about Lula's personal vulnerability and the potential for a full-blown institutional crisis that could largely paralyze the executive and legislative branches for months to come. End summary.

The "Official Story"...

[1](#)2. (SBU) Over the past several days, senior figures in the PT and GOB have tried to establish a consolidated line of defense against the mushrooming scandals dominating Brazil's political class and media (reftels). Last weekend, following careful rehearsal with PT attorneys, ex-PT treasurer Delubio Soares and Marcos Valerio, an advertising businessman implicated as a money man working for the PT in suspect financial activities, presented the following account to Brazilian judicial authorities: Funds "loaned" by Valerio's firms to the PT were destined for the party's "caixa 2" (Brazilian political slang for off-the-books operating funds) to pay party debts from 2002 and 2004 election campaigns. They claimed that moneys were not used for monthly payoffs to coalition congressmen to secure votes, as former PTB party leader Roberto Jefferson and others have alleged (refs); such payoffs would constitute bribery, a criminal act. Rather, the transactions were violations of legal reporting requirements for political parties in Brazil, but not violations of criminal statutes. The moneys were transferred in direct loans to the PT or drawn down by "authorized persons" from bank accounts established by Valerio's firms using loans which Valerio apparently secured by presenting as collateral lucrative contracts his advertising firms had won with state entities. Jose Dirceu and ex-PT Secretary General Silvio Pereira were aware of the transactions, according to Soares and Valerio, but Lula was not (former PT President Jose Genoino's role is not clear).

[1](#)3. (SBU) In a television interview with a Brazilian journalist on 17 July in Paris, Lula endorsed this account, saying the affair is limited to some elements of the PT falling into unsavory practices that are "systematic" among Brazilian parties, specifically use of the "caixa 2." He expressed regret but tried to place the problem in the broader context of structural defects in Brazilian politics and distanced himself and his government from mistakes made by party members of a PT that had "grown too rapidly" and whose "best elements" had migrated to the government.

[1](#)3. (SBU) That is now the "official story" and Lula and those close to him seem rallied around it, even as rank and file PT members fume at their party's fall into disrepute and erstwhile Lula confidants like Genoino find themselves cast

off a listing boat. This version --if it sells-- could armor the president against direct connection to the admitted impropriety, which would be relegated to the arcane area of Brazilian electoral regulations rather than criminal law. The PT would be penalized by the electoral officials, Delubio and others would go into the political wilderness, the fate and direction of the party would remain unclear until September's party convention, but the crisis might be contained.

... That is Falling Apart

14. (SBU) But the story isn't selling, it is falling apart rapidly. Reiterating the "official" version before congressional investigating committees on 20 and 21 July, Delubio Soares and Silvio Pereira were met by expressions of exasperation and incredulity by their questioners, and the men repeatedly refused direct answers on key points, invoking the right to avoid self-incrimination. In the face of continuing revelations in the media of the long and varied list of persons "authorized" to make cash withdrawals from Valerio's accounts, it is becoming impossible to plausibly claim the moneys were going only to cover PT campaign debts. Throughout the week Brazilian newspapers published names from Valerio's unsealed bank records that include senior party figures from not only small coalition parties but from the PT itself, as well as congressional staff members and even relatives of politicians (including the wife of former president of the Chamber of Deputies, Sao Paulo PT deputy Joao Paulo Cunha). The impression is being reinforced daily that the suspect moneys were, in fact, being used for monthly pay-offs for votes, and quite possibly for other illegal purposes, and not just for PT debts. Reportedly huge amounts of money - perhaps as much as Reals 60 million (about 30 million dollars) in total or more -- were withdrawn, with use of armored cars to transport the cash required in some instances.

Comment:

15. (C) Throughout the growing scandals, the government, much of the opposition, and the Brazilian public have seemed to want to avoid a full-blown institutional crisis. The government obviously fears demolition; the leading PSDB and PFL opposition want to appear responsible, playing the role of a worthy government in waiting ready to take on a weakened Lula at the 2006 polls; the public worries about political paralysis. All fear damage to Brazil's image abroad that could torpedo Brazil's hard-won economic stability. But it seems likely that investigators and Brazil's aggressive media will continue to tear the "official" story to shreds. There are just too many opportunities to find inconsistencies and uncover new facts, as implicated parties scramble to divert blame or to cut deals. Hence the executive branch will continue to find itself preoccupied with damage control and the congressional scene will remain lurid and frenetically focused, with competing CPIs serving up sensational revelations and self-righteous pruning by those legislators who are not themselves under scrutiny. In this environment, and given the Lula government's already abysmal record in dealing with the congress, it is difficult to imagine progress in the next months on major agenda items, with the possible exception of political reform. This unproductive interregnum will also be followed in short order by distractions of the 2006 campaign season, leading many commentators to opine that the Lula government, in terms of ability to address major domestic issues, is now virtually over. Such a completely pessimistic prediction may be premature, but the trends are not encouraging.

16. (C) Comment continues. Then there is the question of Lula himself. He is a fighter and continues to enjoy deep reserves of good will in Brazil and abroad; recent polls show his personal popularity remains strong. Yet the sheer dimension of a scandal that involves senior PT members diverting huge sums of public money into what looks increasingly like a carefully constructed artifice for bribery on a grand scale is mind-boggling even for a Brazilian public that is often cynical and stoic about corruption. In this light, it seems folly on the part of the president's advisors to have allowed him to associate himself so clumsily with an account that is already perceived as a cover story, one that will not survive even a few days of scrutiny. There is intensifying concern that Lula will not remain untouched by the crisis. The worst case scenario of impeachment investigations still seems very remote to us -- more concrete proof would need to be produced than that presented to date that Lula was complicit in wrongdoing or ommissive in taking action against it once he became aware. Moreover, the public and congress are loath to confront such a national trauma. But we could face a situation in which Lula's governance capacity becomes deeply eroded and he personally is increasingly seem as a distracted, disconnected and even negligent leader. The next few weeks will be a crucial time and we will provide regular updates and analysis on major developments.

